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No. 87-1392

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

FIRST AMERICAN NATIONAL BANK OF KNOXVILLE,
Appellant,

vs.

DUDLEY TAYLOR,
Commissioner of Revenue for the State of Tennessee,
Appellee.

On Appeal from the Supreme Court of Tennessee

[redacted]E BRIEF AMICI CURIAE PRIOR TO CONSIDERATION OF THE JURISDICTIONAL STATEMENT AND BRIEF OF FIRST TENNESSEE BANK NATIONAL ASSOCIATION, THIRD NATIONAL BANK IN NASHVILLE AND COMMERCE UNION BANK, AMICI CURIAE

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First Tennessee Bank National Association, Third National Bank in Nashville, and Commerce Union Bank hereby respectfully move for leave to file the attached *Brief Amici Curiae* in this case pursuant to Rule 36.1 of the Supreme Court Rules. The consent of both the Appellant and Appellee have been obtained.

The interests of the *amici curiae* in this case arise from the fact that each is a party to a case presently pending in the Chancery Court of Davidson County, Tennessee. In these suits, each amicus has alleged it has received interest on obligations of the State of Tennessee and its political subdivisions, that it has received interest on obligations of the United States, that the attempted imposition of the Tennessee Excise Tax on Tennessee state and local interest and on Federal interest is in violation of the various provisions of the Constitution and statutes of the United States of America and the Constitution and statutes of the State of Tennessee. In this and many other respects, the situation of each *amicus* is virtually the same as that of First American in the instant case. As such, each *amicus* has a substantial interest in the outcome of the above-captioned First American suit.

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DUDLEY TAYLOR,
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On Appeal from the Supreme Court of Tennessee

BRIEF OF FIRST TENNESSEE BANK NATIONAL ASSOCIATION, THIRD NATIONAL BANK IN NASHVILLE AND COMMERCE UNION BANK, AMICI CURIAE

Amici Curiae, First Tennessee Bank National Association, Third National Bank in Nashville and Commerce Union Bank, file this brief prior to the consideration of the jurisdictional statement pursuant to the accompanying motion for leave to which all parties have consented.

INTEREST OF AMICI CURIAE

The interest of the Amici Curiae is set out in the motion for leave to file.

THE QUESTIONS PRESENTED

The appeal by First American National Bank of Knoxville ("First American") presents two important and substantial questions under the Constitution of the United States:

> First, whether the 1983 amendment of the Tennessee Excise Tax Law, Tennessee Code Annotated §§67-2701 *et seq.* (present §§67-4-801 *et seq.*), to tax the income from previously exempt Tennessee obligations violates the Contract Clause, Article I, Section 10, Clause 1 of the United States Constitution, with respect to Tennessee obligations issued and outstanding at the time of the amendment, and if so, whether the Federal Public Debt Statute, 31 U.S.C. §3124(a), further prohibits the State of Tennessee from imposing Excise Tax on the income from similar federal obligations; and
>
> Second, whether, regardless of this Court's decision on the Contract Clause issue, the Tennessee Excise Tax fails to meet any exception in the Federal Public Debt Statute, 31 U.S.C. §3124(a), and therefore violates such statute by taxing the income from federal obligations.

I. SUBSTANTIALITY OF FIRST ISSUE

In January of 1983, this Court ruled in *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983), that the Tennessee Bank Tax imposed upon "net earnings" impermissibly discriminated against federal obligations in violation of the

predecessor statute of 31 U.S.C. §3124. Under the Tennessee Bank Tax Law then in effect, income from Tennessee state and local obligations was excluded from the definition of net earnings while income from federal obligations was included in net earnings. Thus, income from federal obligations was taxed, and income from state obligations was exempt, a situation found to be clearly discriminatory by this Court.

The same definition of net earnings was used for both the Tennessee Bank Tax and the Tennessee general corporate Excise Tax. The Tennessee Excise Tax as in effect prior to 1983 was subsequently held to be in violation of the Federal Public Debt Statute in *Midland Bank & Trust Co. v. Olsen*, 717 S.W.2d 580 (Tenn. 1986), *cert. denied*, ____ U.S. ____, 107 S.Ct. 1336 (1987). Immediately after the *Memphis Bank* decision, the Tennessee General Assembly anticipated that the Tennessee Excise Tax would be subsequently held unlawful as to income from federal obligations. Therefore, the Tennessee General Assembly amended the Tennessee Excise Tax by Chapter No. 227 of the Public Acts of the General Assembly of 1983, effective for years ending on or after May 3, 1983. Chapter No. 227 is reproduced in the Appendix at p.p. A-1 through A-6. The only purposes of the 1983 amendment were to repeal the Tennessee Bank Tax, Tennessee Code Annotated §§67-751 *et seq.*, to amend Tennessee Code Annotated §67-2704 (present §67-4-804) to extend the definition of net earnings and hence the taxable base of the Tennessee Excise Tax to include income from both federal and Tennessee obligations, and to provide for the allocation of the revenue generated among the cities, counties and state.

The Amici Curiae support First American's contention that by enacting the 1983 amendment, the State of Tennessee impaired its contracts with its bondholders and that the constitutionality of this action raises a substantial question. The situation is indistinguishable on its facts from the decision of this Court in *Macallen Co. v. Massachusetts*, 279 U.S. 620 (1929). Although this case has been narrowed in its scope by subsequent

decisions, the case is still controlling precedent where, as here, the facts are indistinguishable. Moreover, the subsequent cases decided in the 1930's and 1940's narrowing the scope of the *Macallen* decision are contrary to the trend of recent decisions since the *Memphis Bank* case of this Court in 1983.

The *Macallen* case, like the present case, involved an excise tax. The Massachusetts excise tax law originally exempted the income from both federal and state obligations. Massachusetts then amended its excise tax statute to delete the exemption of interest income received from federal and Massachusetts obligations.

This Court held that the amendment of the statute to tax interest on both federal and state obligation was invalid. As to federal securities, the intentional imposition of the tax was held to be in violation of the Federal Public Debt Statute as in effect at that time. As to state securities, it was held that the tax "impairs the obligation of the statutory contract of the state by which such bonds were made exempt from state taxation." 279 U.S. at 634.

In words subsequently echoed by this Court's recent interpretations of the Federal Public Debt Statute in *Memphis Bank & Trust Co. v. Garner, supra, American Bank & Trust Co. v. Dallas County*, 463 U.S. 855 (1983), and *First National Bank of Atlanta v. Bartow County*, 470 U.S. 583 (1985), the *Macallen* court rejected artificial distinctions between direct and indirect taxes in determining whether or not an unconstitutional impairment of contract had occurred and stated:

> It necessarily follows that the [Massachusetts] Legislature may not, by an artful use of words, deprive this court of its authority to look beyond the words to the real legislative purpose.
>
> 279 U.S. at 630

> We conclude that the amended act in substance and effect imposes a tax upon federal bonds and securities; and it necessarily follows that the act in substance and effect also imposes a tax upon the county and municipal bonds.
>
> 279 U.S. at 634

Subsequent decisions of this Court limiting the *Macallen* decision fall into two lines. One line of cases has limited the precedential value of the *Macallen* decision but only insofar as it held that a state tax was invalid simply because it treats those who deal with the federal government differently than it treats others. *See Washington v. United States*, 460 U.S. 536, 542 (1983); *Phillips Chemical Co. v. Dumas Independent School District*, 361 U.S. 376, 382 (1960); and *United States v. City of Detroit*, 355 U.S. 466, 472 (1958). These cases, however, do not involve issues under the Contract Clause and do not limit the precedential effect of the *Macallen* decision under the Contract Clause.

The other line of cases dealing with the Contract Clause, has been careful to distinguish, but not to reject, the *Macallen* decision. *Macallen* was distinguished in *Pacific Co. v. Johnson*, 285 U.S. 480, 494-95 (1932), involving a challenge to a California tax on the privilege of doing business within the state. The tax was measured by net income, including interest income received from federal, state, municipal and other bonds. The facts as stated by the Court indicate that the taxpayer held only improvement district bonds and challenged the act under the Contract Clause. The Court upheld privilege taxes measured by the net income of the taxpayer without discrimination as to its source. In upholding the tax, the Court specially noted that the State of California had indulged in no reversal of policy so far as the measurement of the franchise tax was concerned and in no discrimination either in favor of or against tax exempt income. California instead adopted a new form of privilege tax upon corporations measured by their net income without any form of discrimination as to the sources of the income included in the measure.

Tradesmens National Bank v. Oklahoma Tax Commission, 309 U.S. 560 (1940), similarly involved a new form of taxation on national banks levied upon income from all sources including interest income received on obligations of the United States. The *Tradesmens* case involved only a challenge to the taxation of income from federal securities and not a challenge to the taxation on state securities under the Contract Clause. Nevertheless, the case supports the distinction made in *Pacific Co. v. Johnson, supra*, between a new form of taxation imposed on all income without any form of discrimination as to the sources of income versus an amendment specifically for the purpose of taxing previously exempt income. The Court in *Tradesmens*, after discussing the effect of the *Pacific Co.* opinion on the *Macallen* case, specifically left open what circumstances would bring a situation within the precise scope of the *Macallen* case. 309 U.S. at 566.

The appeal of First American presents a case precisely within the scope of the *Macallen* case. Both the Massachusetts and Tennessee taxes are excise taxes on the privilege of doing business in a state as a corporation. Prior to the Massachusetts and Tennessee amendments, both income from federal and state obligations was exempt. In Massachusetts, this result was required by statute. In Tennessee, the exemption of income from state obligations was required by state statute, and the exemption of income from federal obligations resulted from court decisions under the Federal Public Debt Statute. Both the Massachusetts and Tennessee amendments were solely for the purpose of reversing prior exemptions. Neither the Massachusetts nor the Tennessee amendment was part of a new form of taxation imposed on net income without discrimination as to source. No valid grounds apply for distinguishing the *Macallen* case from the First American case, and *Macallen* still remains as precedent within its narrow scope.

Furthermore, the decisions of this Court have always applied similar standards in interpreting the Federal Public Debt Statute

and the Contract Clause even though these standards have varied from time to time. Thus, in the *Macallen* case, the excise tax, even though in the nature of a privilege tax, was held in substance and effect a tax on federal, county and municipal bonds for purposes of both the Federal Public Debt Statute and the Contract Clause. 279 U.S. at 634. In *Pacific Co. v. Johnson, supra,* a new form of privilege tax on all sources of income, including interest on state obligations, was held not to violate the Contract Clause, and in *Tradesmens National Bank v. Oklahoma Tax Commission, supra,* a new form of privilege tax on all sources of income, including interest on federal obligations, was similarly held not to violate the Federal Public Debt Statute. In recent decisions under the Federal Public Debt Statute, this Court has rejected the "formal but economically meaningless distinction between taxes on Government obligations and taxes on separate interests [that] was 'firmly indebted in the law.' " *See, for example, American Bank & Trust Co. v. Dallas County, supra,* 463 U.S. at 858. Therefore, the Court in order to maintain the consistency of interpretation should reject the formal but economically meaningless distinctions relied upon by the Tennessee Supreme Court in its decision under the Contract Clause.

The Amici Curiae do not urge this Court to prohibit the State of Tennessee from ever amending its Excise Tax Law to tax Tennessee obligations. The State of Tennessee clearly has the right to do so with respect to obligations issued after the date of the 1983 amendment. To avoid an impairment of contract, only the previously issued and outstanding obligations are required to be grandfathered. A grandfathering of issued obligations from the effect of any such amendment balances the state's need for flexibility in changing its tax laws with the rights and expectations of state bondholders under their contract with the state.

The State of Tennessee by promising an excise tax exemption has induced corporate taxpayers to purchase Tennessee obligations over the course of many years. It is certain that the promised exemption induced many of these corporate taxpayers to

purchase the Tennessee obligations even though they could have received a higher yield (prior to Tennessee taxes) by purchasing taxable bonds or obligations of other states, which were also exempt from federal taxes, but not Tennessee taxes. These bondholders have also been induced by the promise of tax exemptions to purchase Tennessee obligations rather than higher-yielding, fully taxable obligations. Common sense dictates that it is not only possible, but probable, that the repeal of the Tennessee Excise Tax exemption had an adverse effect on the value of the Tennessee obligations and the ability of Tennessee bondholders to resell these obligations. It has generally been assumed that a tax-exempt feature tends to increase, and is reflected in, the market price of securities, and that a state tax burden would adversely affect value. *Commonwealth v. Curtis,* 363 Pa. 299, 69 A.2d 410 (1949). Without a positive *factual finding* by the trial court that there was no adverse effect, it was erroneous for the Tennessee Supreme Court to determine that no impairment of contract had in fact occurred.

Once income from any class of Tennessee obligations has been held to be exempt from the Tennessee Excise Tax in order to avoid a violation of the Contract Clause, then the same exemption must be afforded to income from similar federal obligations in order to avoid the discrimination condemned by this Court in *Memphis Bank & Trust Co. v. Garner, supra.* Assuming that this Court would hold that the Contract Clause is violated by the imposition of the Tennessee Excise Tax on Tennessee obligations issued and outstanding prior to the effective date of the amendment, May 3, 1983, and that therefore income on such obligations may not be taxed, then the income on federal obligations issued before the same date must also be excluded from the Excise Tax to avoid a violation of the Federal Public Debt Statute.

It is respectfully submitted that the issue arising under the Contract Clause of the United States Constitution is substantial and deserving of full consideration by this Court. Virtually

every bank in the state of Tennessee holds Tennessee obligations affected by the repeal of the Excise Tax exemption. These banks purchased Tennessee obligations which carried with them an Excise Tax exemption, and the State of Tennessee has impaired the value of these obligations by the repeal of the exemption. The *Macallen* case presented precisely the same facts and issues, and despite subsequent erosion of this case, its authority as controlling precedent on the precise issue on appeal by First American has never been overturned. It was therefore erroneous of the Tennessee Supreme Court to fail to apply the *Macallen* decision.

II. SUBSTANTIALITY OF SECOND ISSUE

In *Memphis Bank and Trust Co. v. Garner, supra,* this Court held invalid state taxes which discriminated against federal obligations by taxing interest received on federal obligations while exempting interest received on state obligations. In *American Bank & Trust Co. v. Dallas County, supra,* this Court held invalid a bank shares tax even though there was no discrimination between federal obligations and state obligations. The Court held that the Federal Public Debt Statute as amended in 1959 eliminated the previous "formal but economically meaningless distinction between taxes on Government obligations and taxes on separate interests," such as a privilege tax measured by the value or income from Government obligations. 463 U.S. at 858. Bank share taxes were held not to be within any exception to the Federal Public Debt Statute, and it was further held that there was no suggestion in the statute that some category of state taxes apart of those specifically preserved was to be impliedly excepted. 463 U.S. at 864 n. 8.

The principles established in the *Garner* case appear to have been readily grasped by the state legislatures, and discriminatory tax statutes have been generally eliminated. However, the principles established in the *American Bank* case had not been so readily absorbed, and states have attempted to

save prohibited forms of taxation of federal obligations by the facile use of words. For example, in *Dale National Bank v. Pennsylvania,* 502 Pa. 170, 465 A.2d 965 (1983), the Supreme Court of Pennsylvania reviewed an attempt by the Pennsylvania legislature to avoid the application of the Federal Public Debt Statute by a mere change of words. After the *American Bank* case, the Pennsylvania legislature passed a new act calling its banks shares tax "a tax for the privilege of doing business" in Pennsylvania, *i.e.* a franchise tax. The Pennsylvania Supreme Court held that despite the change, the tax was and continued to be a property tax identical in operation and effect to a bank shares tax indistinguishable from the one invalidated in *American Bank.* Therefore, the Pennsylvania Supreme Court held the tax invalid insofar as it applied to federal obligations.

The courts in other states have shown substantial disagreement as to whether the courts should be satisfied with the name given to the tax by the legislature or should consider the substance and effect of the tax. *See,* for example, *First Union National Bank v. Florida Department of Revenue,* 502 So.2d 964 (D. Ct. App. Fla.), *rev'd,* 513 So.2d 114 (Fla. 1987), *appeal docketed,* No. 87-1074 (U.S. Dec. 23, 1987). Florida imposes a franchise tax on every bank and savings association in the state measured by net income. The District Court of Appeal held that the Florida bank "franchise" tax was nothing more than a mislabeled income tax. The Court found that the "franchise" tax operated in the same manner as the Florida general corporate income tax, that the measure of both taxes was the same, that the rates imposed by each tax was identical, and that both taxes were levied upon corporations for the privilege of doing business in the state. The only cognizable difference between the two taxes was held to be the statutory labels. Nevertheless, the Florida Supreme Court reversed the holding of the District Court of Appeal based on the "formal but economically meaningless distinction" of the name given to the tax. 513 So.2d at 116. *See also, Centerre Bank of Crane v. Director of Revenue,* No. 69047, Slip Op. (Mo. Jan. 20, 1988), upholding a tax measured by income as a franchise tax.

In *American Bank & Trust Co. v. Dallas County, supra,* 463 U.S. at 863, this Court stated:

> [F]ranchise and estate and inheritance taxes customarily assess the franchise or the demise at the value of the assets of the business or at the value of the property inherited. *See, e.g., Werner Machine Co. v. Director of Taxation,* 350 U.S., at 492, 76 S.Ct., at 534 (franchise tax measured by 'net worth'); *Plummer v. Coler,* 178 U.S., at 134, 20 S.Ct., at 836 (inheritance tax measured by 'the value of the property passing'); *Home Ins. Co. v. New York,* 134 U.S., at 599, 10 S.Ct., at 595 (franchise tax measured by 'capital stock and dividends').

By excepting only franchise, estate and inheritance taxes, it is clear from the context of 31 U.S.C. §3124(a), that Congress intended only to provide exceptions for state taxes based on net worth or the value of the obligations. Income taxes, and taxes which are in substance and effect indistinguishable from income taxes, are strictly prohibited. Congress, by specifying that a franchise tax would be excepted from the general prohibition, clearly meant to refer to a specific type of privilege tax, a tax on net worth. Otherwise, Congress would have eliminated several surplus words in 31 U.S.C. §3124(a)(1) and merely provided an exception for "a nondiscriminatory * * * nonproperty tax * * * imposed on a corporation . . ." The interpretations of this statute given by the Tennessee, Missouri and Florida courts have pared down the statute to the words quoted above and failed to give full meaning to each and every word used by Congress in enacting the statute. As held in *McDonald v. Thompson,* 305 U.S. 263, 266 (1938), the rule is that all words of a statute are to be taken into account and given effect if that can be done consistently with the plainly disclosed legislative intent. The legislative intent of Congress was plainly to restrict state taxation of federal obligations, and this intent will be served by giving effect to each word and specific term in 31 U.S.C. §3124(a)(1).

Regardless of whether or not a franchise tax may properly be measured by income, the Federal Public Debt Statute clearly prohibits more than one franchise tax or alternative nonproperty tax in lieu of a franchise tax. Tennessee imposes a nondiscriminatory franchise tax, T.C.A. §§67-4-901 *et seq.*, on the net worth of banks and other corporations doing business in the State of Tennessee. The measure of net worth for Tennessee franchise tax purposes includes the value of federal and state obligations without discrimination. Consequently, the Tennessee Excise Tax is an additional tax in excess of the one franchise tax permitted under 31 U.S.C. §3124(a)(1).

Despite the fact that 31 U.S.C. §3124(a)(1) uses only the singular to describe "a" franchise tax within its exception and despite the fact that a nonproperty tax is excepted only if it is "instead of" a franchise tax, the Tennessee Supreme Court found that the State of Tennessee was not limited to one corporate tax on federal obligations. Instead, the Court stated:

> Consequently, a number of acceptable forms of taxation can be imposed within this exception and we do not think that such a significant limitation on the taxing authority of the States should be readily inferred from this statutory language without a more definite expression Congressional intent.
>
> Slip Op. p. 11.
> Appendix to the Jurisdictional
> Statement at pp. 9a-10a.

The Tennessee Supreme Court has ignored the clear mandate of this Court's decision in *American Bank & Trust v. Dallas County, supra,* that any exceptions in the Federal Public Debt Statute must be narrowly construed. The Tennessee Supreme Court has further ignored the fact that the State of Tennessee is encroaching upon federal sovereignty by the exercise of its taxing power and that any doubts must be resolved in favor of intergovernmental immunity instead in favor of the exercise of the state's taxing power.

In *M'Culloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819), this Court stated that "the power to tax involves the power to destroy." The Court concluded that a state cannot tax a federal instrumentality (the Bank of the United States) without the federal government's consent. In this case, the federal government has agreed under 31 U.S.C. §3124(a)(1) to permit states to impose some forms of taxation on federal obligations. Clearly, however, the federal government did not intend to surrender to the states the "power to destroy" the ability of the federal government to issue obligations and therefore the exceptions in 31 U.S.C. §3124(a) are very limited.

The Tennessee Supreme Court has incorrectly construed these narrow exceptions as permitting corporate taxation without limitation. In the Tennessee Supreme Court's opinion, any tax on a corporation can be labeled a franchise tax, and franchise taxes can be levied on top of franchise taxes, without limitation as to number. So construed, the exceptions in 31 U.S.C. §3124(a)(1) would devour the rule against state taxation of federal obligations held by corporations. In view of the fact that a substantial portion of federal obligations, if not most federal obligations, are held by banks, savings associations, and other corporations, the power to destroy the federal government's ability to borrow from corporations would have a devastating effect on the United States Treasury. This power to destroy will be established by the decision of the Tennessee court in First American's case unless reversed by this Court.

Finally, the Tennessee Supreme Court has misconstrued the decision of this Court in *First National Bank of Atlanta v. Bartow County, supra*, holding that with respect to a tax which cannot be levied upon federal obligations, federal obligations should nevertheless not be permitted to shelter other taxable assets. The *Bartow* case involved a property tax on bank shares measured by the bank's net worth as shown on its balance sheet. This Court approved the state's action in allocating a proportionate amount of the liabilities of the bank to the federal

obligations which the bank held as assets. Thus, the net worth taxable base was reduced by the net amount of federal obligations after the allocation of liabilities rather than by the gross amount of federal obligations.

The Tennessee Supreme Court quotes the *Bartow* decision as supporting its conclusion that no "significant limitation on the taxing authority of the States" should be inferred by the Federal Public Debt Statute. The *Bartow* decision very carefully distinguishes between forms of taxation and the scope of the exemption which must be provided to federal obligations if a tax is not within one of the exceptions under 31 U.S.C. §3124(a)(1). 470 U.S. at 589. *Bartow* preserves the power of the states to tax the non-exempt assets of banks by eliminating the ability of the bank to protect its *net* assets from taxation by the *gross* amount of federal obligations. It clearly does not, however, authorize states to impose taxes on federal obligations held by corporations outside the narrow exceptions in 31 U.S.C. §3124(a)(1).

The question presented by First American's appeal is substantial. The decisions by the Tennessee, Florida and Missouri courts will, if unchecked, impede the ability of the United States to borrow from corporations. These decisions are also inconsistent with prior precedent. *See, for example, Federal Products Corp. v. Norberg,* 429 A.2d 447 (R.I. 1981), holding that Rhode Island could not impose a business corporation tax on the income received from federal obligations when that state already had a franchise tax in addition to the business corporation tax.

This Court's recent dismissal of the appeal in *Garfield Trust Co. v. Director, Division of Taxation,* ____ U.S. ____, 107 S.Ct. 390 (1986), *dismissing appeal from* 102 N.J. 420, 508 A.2d 1104 (1986), is not determinative of the issues in First American's appeal. That case involved a single tax with two bases: a net worth base and a net income base. An examination of the decision below shows that although the tax on federal obligations was upheld in that case, no issue was raised or rejected by the New Jersey Supreme Court as to whether 31

U.S.C. §3124(a) limits a state to one franchise tax on federal obligations. The New Jersey banks could have raised, but apparently chose not to raise, the issue that New Jersey was imposing two taxes disguised as one. Since the New Jersey decision does not address this issue, this Court's dismissal of the appeal has no precedential impact on the issue now before the Court.

In conclusion, it is clear that the issues raised by First American under the Federal Public Debt Statute, 31 U.S.C. §3124(a), are substantial and demonstrate that the decision below is erroneous. The decision of the Tennessee Supreme Court effectively eliminates any restrictions whatsoever on state taxation of federal obligations in the hands of a corporation. Banks, other financial institutions and other corporations represent a substantial source for funding the federal debt. In order to protect the access of the federal government to corporate lenders, it is necessary that this Court delineate for the states the boundary of state taxation of federal obligations allowed under 31 U.S.C. §3124(a)(1) and to check state intrusions beyond this boundary.

CONCLUSION

For these reasons, the Court should note probable jurisdiction over the appeal by First American.

Respectfully submitted,

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APPENDIX

APPENDIX

CHAPTER NO. 227 OF THE PUBLIC ACTS OF THE TENNESSEE GENERAL ASSEMBLY OF 1983

AN ACT to include in the definition of net earnings for corporate excise tax purposes interest income earned on state and local obligations, to provide for the allocation of revenue derived from the taxation of banks under Tennessee Code Annotated, Title 67, Chapter 27 as provided by Article 2, Section 28 of the Tennessee Constitution, to amend Tennessee Code Annotated, Title 67, Chapter 27, Section 67-2704 and to repeal Tennessee Code Annotated, Sections 67-751 through 67-763.

BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF TENNESSEE:

SECTION 1. Tennessee Code Annotated, Sections 67-751 through 67-763, are hereby repealed.

SECTION 2. Tennessee Code Annotated, Section 67-2704, is amended by substituting for subdivision (1)(B) of subsection (b) the following:

(B) Interest income from obligations defined in 26 U.S.C. Section 103(a)(1) less allowable amortization.

SECTION 3. Tennessee Code Annotated, Title 67, Chapter 27, is amended by adding a new section which shall read as follows:

67-2733. All the taxes collected under this chapter shall be applied as follows:

(a) To cities and counties, an amount to be determined, allocated and administered in the following manner for each bank doing business in this state:

(1) Three percent (3%) of the net earnings of the bank for the fiscal year second preceding the year in which

the distribution under this section is made less ten percent (10%) of the ad valorem taxes paid by the bank on its real property and tangible personal property for the fiscal year second preceding the year in which said distribution is made. For the purposes of this subsection, the term net earnings shall not include amounts attributable to interest earned on bonds and other obligations of the State of Tennessee. The total amount thus determined shall be allocated between the county and municipal governments where the principal office of the bank is located in the same proportion as the property tax rate of each such taxing jurisdiction shall bear to the sum of said property tax rates.

(2) In no event shall the amount of this tax to be allocated to cities and counties in any year be less than an amount calculated on the basis of sixty percent (60%) of the book value of each bank as of December 31, 1976 except that the sixty percent (60%) book value of any bank which has been in business for five years or less shall be determined as of the first year such bank is in business and the sixty percent (60%) book value of the fifth year shall be used for the sixth year and all years thereafter. The book value of any bank shall be the sum of the paid in capital, surplus and undivided profits, to include any capital reserves.

In these calculations for the minimum allocation, the following shall be deducted from the sixty percent (60%) book value:

(A) The appraised value of all real property and tangible personal property owned directly or indirectly by the bank and assessed to it for the fiscal year second preceding the year in which the distribution under this section is made.

(B) The appraised value of all real property in Tennessee occupied by the bank and used for the purpose of conducting its business and upon which it paid the ad valorem taxes for the fiscal year second preceding the year in which the distribution under this section is made under terms of a lease requiring that such taxes be paid by the bank and said lease has been registered in the county where such property is located.

A ratio of forty percent (40%) shall be applied to the remaining book value and to this resulting amount the tax rates for the year second preceding the year in which the distribution under this section is made of the county and municipality where the principal office of the bank is located shall be applied to determine the minimum amount to be allocated to each such respective taxing jurisdictions.

(3) In circumstances where a bank has branches or offices in a county or counties other than the county where its principal office is maintained, the total allocation attributable to such bank as determined above shall be further allocated between such counties and cities where its principal office and branches or offices are located as follows:

(A) The proportionate percentage that is produced by the ratio of the deposits of each branch or office of the bank to the total deposits of the bank shall be determined as of January 1 of each year and the percentage so determined shall then be applied to the total allocation to determine the portion of the total attributable to each branch or office;

(B) The branches or offices shall then be grouped each to a common location so as to

determine the aggregate allocation of all branches or offices located in each individual county and municipality; and

(C) The percentage of the total allocation allowable to each county and municipality shall be divided between the county and municipality where the branch or office is maintained in the same proportion as the property tax rates of each for the year second preceding the year in which the distribution under this section is made shall bear to the total of the said property tax rates.

(4) The Director of the Division of Property Assessments shall provide to the Commissioner of Revenue, on an annual basis, the calculations necessary to make the proper allocations to counties and municipalities as determined pursuant to this subsection. The Commissioner of Revenue shall provide to the Director of Property Assessments, periodically on a timely basis, the net earnings figure of each bank doing business in this state as determined pursuant to this subsection. Internal procedures as deemed necessary to effect these purposes may be jointly developed by the Commissioner of Revenue and the Director of the Division of Property Assessments.

(5) The allocation attributable to any bank which has been in business less than five (5) years shall be reduced proportionately at the rate of one-fifth (1/5) for each year less than five (5) it has been in business.

(6) In the event the net earnings of any bank shall be redetermined for any period in accordance with this chapter, the Commissioner of Revenue shall advise the Director of the Division of Property Assessments

of the corrected net earnings, the Division of Property Assessments shall then recalculate the allocation attributable to such bank and any indicated increase or decrease in allocation shall be effected in the next succeeding general allocation to the respective county and municipal governments, as appropriate.

(7) The Director of the Division of Property Assessments shall have authority and power to prescribe forms upon which all banks shall report such facts and information as will enable said division to ascertain the correctness of the allocation. The Division of Property Assessments shall furnish such forms to each bank on or before April 1 of each year, or as soon thereafter as possible, and banks shall return completed forms to said division on or before May 15 of each year. The Division of Property Assessments shall have full power to summon witnesses, to inspect or require the production of books and papers, and to obtain and consider any evidence and records other than the reports submitted by such banks which it may deem proper or necessary to carry out its responsibilities under this subsection. In the event any bank subject to the provisions of this Act fails, refuses or neglects to complete and file such form with the Division of Property Assessments as herein provided, said division shall determine the amount of the allocation in regard to such bank on the basis of the best information available.

(b) After allocations to counties and municpalities as provided above, the remainder of the taxes collected under this chapter shall be applied to and become a part of the general fund of the state.

SECTION 4. The legislature is hereby exercising its discretion granted in Article 2, Section 28 of the Constitution of Tennessee to establish the manner in which banks shall be taxed.

The allocation of taxes to local governments herein provided shall be in lieu of the taxation of the subclassification of intangible personal property designated as "shares of banks and banking associations, and all taxes on the redeemable or cash value of all their outstanding shares of capital stock, certificates of deposit and certificates of investment, by whatever name called, of such bank or banking association provided that such bank or banking association shall nonetheless continue to be subject to ad valorem taxes on its real property and tangible personal property and all other taxes to which it is currently subject.

SECTION 5. This Act shall take effect upon becoming law, the public welfare requiring it. The provisions of Section 2 of this Act shall be applicable only for fiscal years of such corporations subject to this tax ending on or after the effective date of this Act. The first allocations under Section 3 of this Act shall be made to local governments in the third quarter of each state fiscal year commencing with the state fiscal year beginning July 1, 1983.

Tennessee Code Annotated §67-2704
(1983 Supplement) (After amendment by Chapter No. 227)

67-2704. "Net earnings" defined. — (a) The term "net earnings" is defined, at the option of the taxpayer, as:

(1) Federal taxable income before the operating loss deduction and special deductions provided for in Sections 241-247, 249, and 250 of the Internal Revenue Code (26 U.S.C. Sections 241-247, 249, and 250) prior to its amendment by the Economic Recovery Tax Act of 1981, Public Law No. 97-34, Sections 201-209; or

(2) Federal taxable income before the operating loss deduction and special deductions provided for in Sections 241-247, 249, and 250 of the Internal Revenue Code (26 U.S.C. Sections 241-247, 249, and 250) after its amendment by the Economic Recovery Tax Act of 1981, Public Law No. 97-34, Sections 201-209, plus one-tenth (1/10) of all depreciation used in computing federal taxable income.

(b) The term net earnings as defined in subsection (a) shall be subject to the following adjustments:

(1) There shall be added to the federal taxable income:

(A) Excise tax imposed by this state to the extent deducted in determining federal taxable income.

(B) Interest income from obligations defined in 26 U.S.C. Section 103 (a)(1) less allowable amortization.

(C) Any deduction made pursuant to §§ 611-617 of the Internal Revenue Code to the extent the deduction when added with similar deductions in prior years exceeds the cost of the property.

(D) Gains not recognized pursuant to § 337 of the Internal Revenue Code.

(E) The charitable contributions deduction claimed under § 170 of the Internal Revenue Code.

(F) Any capital loss carrybacks or carryovers deducted pursuant to § 1212(a) of the Internal Revenue Code.

(G) Any expense or depreciation permitted as a deduction in computing federal taxable income solely as a result of lease characterizations permitted under Section 168 of the Economic Recovery Tax Act of 1981 which would not have been permitted in the absence of such act; it being the legislative intent that excise tax revenue not be reduced due to lease characterizations made for the purpose of transferring investment tax credits and depreciation allowances from one business entity to another.

(2) There shall be subtracted from the federal taxable income:

(A) Dividends earned by a parent corporation from a subsidiary corporation where such parent owns eighty percent (80%) or more of the stock of the subsidiary.

(B) Any amount included in federal taxable income but not taxable under the law of this state.

(C) Any net operating loss incurred, which is defined as the excess of allowable deductions over total income allocable to this state for the year of the loss, and which may be carried over and allowed in succeeding tax years until fully utilized in the next succeeding taxable year or years in which the taxpayer has net income, but in no case for more than three (3) years after the taxable year in which the net operating loss occurs.

(D) A portion of the gain or loss of the sale or other disposition of property having a higher basis for Tennessee excise tax purposes than federal income tax purposes measured by the difference in the Tennessee basis and the federal basis.

(E) Actual charitable contributions made by the corporation during the fiscal year.

(F) Losses not deducted pursuant to § 337 of the Internal Revenue Code.

(G) Any capital losses incurred during the fiscal year and not deductible under § 1211 (a) of the Internal Revenue Code.

(H) Any expense, other than income taxes, not deducted in determining federal taxable income for which a credit against the federal income tax is allowable. This subdivision shall apply to taxable periods ending on and after December 31, 1977.

(I) Any amount included in federal taxable income solely as a result of lease characterizations permitted under Section 168 of the Economic Recovery Tax Act of 1981 which would not have been permitted in the absence of such act.

(J) Any amount of depreciation or other expense which the taxpayer could have deducted in computing federal taxable income had it not made the election to enter into a lease transaction permitted under Section 168 of the Economic Recovery Tax Act of 1981 which would not have been permitted in the absence of such act.